No. 20,981

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN M. ENGLAND, as Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt,

Plaintiff and Appellee,

vs.

ARCHIE SNIDER, individually and dba Snider Construction Co.,

Defendant and Appellant.

On Appeal from the United States District Court for the Northern District of California

BRIEF OF APPELLEE, JOHN M. ENGLAND, AS TRUSTEE OF THE ESTATE OF MAHL ASSOCIATES, INC., A CORPORATION, BANKRUPT

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I. PRELIMINARY MATTERS

A. Jurisdiction

This is an action by the Trustee of a bankrupt estate to recover a preferential transfer alleged to have been made in favor of the defendant. The District Court obtained jurisdiction by virtue of Sections 60 and 67 of the Bankruptcy Act (11 U.S.C. 96, 11

U.S.C. 107). Defendant appealed to this Court from an adverse judgment pursuant to Rule 73, Federal Rules of Civil Procedure.

B. Statement of Facts

Mahl Associates, Inc., a California corporation, was duly adjudged bankrupt by the Court below on January 31, 1962. Appellee here is the Trustee of that bankrupt estate. On April 15, 1961, Appellant leased to the bankrupt the premises upon which the bankrupt had its principal place of business, and these premises thereafter remained the principal place of business of the bankrupt up until the time it filed its Petition in Bankruptcy. Some time before August 1, 1961, Appellant made certain improvements in and to the premises to accommodate the bankrupt's business, and the Appellant thereafter billed the bankrupt for such work in the sum of $5,492.02. Thereafter, on August 15, 1961, Appellant loaned $10,000 to the bankrupt in order that the bankrupt could meet its payroll. At the time of the loan the bankrupt executed its unsecured promissory note dated August 15, 1961 in the sum of $10,000, payable thirty days from its date. The balance due on the note, plus interest thereon, and the amount due for the leasehold improvements were paid to Appellant on or about December 1, 1961 out of the proceeds of the sale of a parcel of real property owned by the bankrupt.

II. ARGUMENT

A. INTRODUCTION

Appellee wishes to briefly reply to the statements of Appellant found under the heading "Introduction" on page 6 of his Opening brief.

Appellant's reference therein as to what will be done with the moneys Appellee may recover herein are inappropriate. The Appellee is duty bound as the Trustee of a bankrupt estate to seek recovery of all funds which may be due the estate, and this duty applies to the recovery of preferential transfers (11 U.S.C. 96). Furthermore, how the moneys are distributed once they are recovered by the Trustee has been decreed by Congress in the Bankruptcy Act. If Congress has deemed that the United States receive priority payment on account of taxes due it, then the Trustee must comply with such decree. The fact that one of the principals of the corporation is thereby relieved of personal liability for such taxes paid (an obligation which he could not meet in any event) should not influence the Court as to whether or not there has been a voidable preferential transfer and the mention of this fact has no place in this appeal.

Appellant makes reference to the doctrine of "Retrojection" used by the Trial Court to determine insolvency at the time of the transfer. We shall discuss this below when discussing the evidence in support of the challenged finding of such insolvency. Contrary to that which is stated in Appellant's "Introduction," the findings are amply supported by the evidence as we shall demonstrate below.

B. IT IS AGREED BY THE PARTIES THAT CERTAIN OF THE ELEMENTS OF A VOIDABLE PREFERENCE REQUIRED TO BE PROVED HAVE SO BEEN PROVED.

In order to establish that a voidable transfer has been made, it is incumbent upon Appellee to establish all of the required statutory elements, to wit: (1) a transfer of the debtor's property; (2) for the benefit of a creditor on account of an antecedent debt; (3) while the debtor is insolvent; (4) within four (4) months of bankruptcy; (5) the effect of which transfer was to enable the creditor to obtain a greater percentage of his debt than other creditors of the same class; and (6) that the creditor had reasonable grounds for believing the bankrupt insolvent at the time he received the transfer. 3 *Collier on Bankruptcy,* 14th Edition, Section 60.02, page 755 *et seq.* It is conceded by Appellant that the Appellee has sustained his burden with reference to proof of these elements except as to numbers 3 and 6. This Brief shall be therefore addressed to the question of whether the evidence supports the finding that elements 3 and 6 have been proved.

C. APPELLEE ESTABLISHED THAT THE BANKRUPT WAS INSOLVENT ON THE DATE OF TRANSFER.

Section 1 of the Bankruptcy Act (11 U.S.C. 1) defines insolvency as existing when the aggregate of one's property, exclusive of property which he has conveyed, is not sufficient to pay one's debts. Was this the condition of Mahl Associates on or about December 1, 1961, the date when the subject transfer was made,

and a bare two months before adjudication? The record fairly shouts an affirmative answer to this question. The Trial Court so found (Finding of Fact No. 9) and on appeal this and all other findings of fact must be presumed to be correct and should not be set aside unless clearly erroneous. *Fed. Rules of Civ. Proc.,* Rule 52. Such findings are presumptively correct and should not be disturbed if supported by substantial evidence. *American Alliance Insurance Co. v. Brady Transfer and Storage Co.,* 101 F 2d 144, *Alliance Ins. Co. of Philadelphia v. Brown,* 36 F 2d 625.

It is not disputed that the bankrupt was insolvent on the date of adjudication, January 31, 1962. Nothing significant had occurred in the two months previous to adjudication. Mr. Mahl, president and general manager of the bankrupt, testified that as far back as September and October, 1961, the business was defunct (R.T. 16). Mr. Mahl further testified that between the latter part of November, 1961 and January 29, 1962, the date on which he signed the Bankruptcy Petition, there was no substantial change in the asset liability ratio of Mahl Associates (R.T. 76). Mr. Leonardo S. Bacci, an attorney at law, testified that he examined the books of Mahl Associates in the latter part of September, 1961 and as a result of such examination advised Mr. Mahl that Mahl Associates should file a Petition in Bankruptcy (R.T. 87-88). Mr. Bacci further testified that the information upon which he based his advice in September 1961 was substantially the same information he used in ulti-

mately preparing the bankruptcy schedules of Mahl Associates, which schedules were thereupon filed in the Court below (R.T. 91-92).

Appellant cannot seriously contend that on the date of adjudication Mahl Associates was not insolvent within the meaning of the Bankruptcy Act. As of the date of the trial of this action, the money on hand in the bankrupt estate was $2478.99. The only other assets consisted of a judgment for $3,000, a sum which might be recovered from a Morris Plan Reserve Account not to exceed $5,000, and whatever might be collected in this present litigation. The unpaid creditors' claims at that time approximated $180,000 (R.T. 98-99). The evidence demonstrates that this was *also essentially the condition of the bankrupt at the time of the transfer.* That Mr. Mahl was attempting to obtain capital to put into the corporation up until the time of bankruptcy does not detract from the validity of Appellee's position, but rather strengthens it. If Mahl had been able to obtain such additional financing before the transfer, then perhaps it would be arguable that Mahl Associates was solvent on the date of transfer. But the fact remains that even though Mr. Mahl may have attempted to obtain money right up until adjudication (as Appellant states on page 9 of his Opening Brief, which statements are unsupported by the citations given) *he was unable to obtain such financing.* No substantial business was done in the three months before adjudication, and beginning in October, 1961 Mahl Associates operated with a skeleton crew (R.T. 47-48). The loans Mr. Mahl was seek-

ing on behalf of Mahl Associates simply did not materialize. That Mr. Mahl was seeking money or that he was optimistic with regard to obtaining financing does not change the actual fact of insolvency. Upon adjudication, whatever *potential* assets Mahl Associates might have had (as referred to on pages 9 and 10 of Appellant's Opening Brief) became the property of plaintiff herein. It has been conclusively demonstrated above that Mahl Associates had substantially more debts than assets on the date of adjudication, *including* such potential assets.

As the Trial Court so aptly put it on page 4 of its Memorandum of Opinion on file herein, "It appears to be an inescapable conclusion that the bankrupt was insolvent at the time of the transfer of the real property or alleged preference."

D. DEFENDANT HAD REASONABLE CAUSE TO BELIEVE THAT THE BANKRUPT WAS INSOLVENT AT THE TIME OF THE TRANSFER.

Whereas in establishing insolvency it is the actual condition of the bankrupt at the time of the transfer that is important, in establishing reasonable cause it is the reasonable belief of the transferee that is relevant. The Trial Court found there was reasonable cause for defendant to believe that Mahl Associates was insolvent on the date of the transfer. The record supports this finding.

Mr. Mahl testified that in October 1961 he had a conversation with defendant at which time and place

a Mr. French, a then employee of Mahl Associates, was present. At that time Mr. Mahl told Appellant that Mahl Associates was insolvent and that he had been informed by his attorney and his accountant to file a Petition in Bankruptcy on behalf of Mahl Associates (R. T. 12-13). Mr. Mahl then testified that he told Appellant that the only asset out of which he could be paid was a parcel of real property (R.T. 13). Mr. French corroborated this testimony (R. T. 50-51). It is true that Appellant denied that this conversation took place, but it is elementary that the decision of the Trial Court as to the credibility of witnesses is presumptively correct. *Metro-Goldwyn-Mayer Corporation v. Fear,* 104 F 2d 892. It has also been held by this Court that the acceptance of testimony by the Trial Court observing the witness on the stand is conclusive on appeal as regards credibility. *Larsen v. Portland California S. S. Co.,* 66 F 2d 326. The Trial Court here clearly found that this conversation took place in spite of Appellant's denial. On page 3 of the Trial Court's Memorandum Opinion it is stated: "Although there is some conflict in the evidence, it appears that Mahl told defendant the business was insolvent and needed recapitalizing. It also appears that in October Mahl informed the defendant of insolvency and that an accountant and an attorney had suggested bankruptcy." It is true, the Trial Court states it did not base its decision on the fact that at the time of the transfer Appellant had actual knowledge of insolvency although the Court found such actual knowledge to exist (Memorandum Opinion,

page 5). But, as stated above, actual knowledge of insolvency is not required, only reasonable cause to believe such insolvency.

The record also reflects that the bankrupt borrowed $10,000 from Appellant to meet payroll, and a thirty-day note was thereby executed by the bankrupt (R.T. 9). There were several conversations between Mr. Mahl and Appellant after the note became due, wherein Appellant demanded payment and Mahl stated that the bankrupt was unable to pay (R. T. 11). Appellant agreed to accept payment out of the proceeds of the sale by the bankrupt of a parcel of real property (R.T. 13-14). At the time of the repayment, the bankrupt owed Appellant back rent from November 1, 1961 (R.T. 113) and the rent for previous months had consistently been paid late (R.T. 116). By virtue of the proof referred to herein and the undisputed facts now before this Court, it has been established that the Appellant was aware of the following at the time he was paid: 1) his loan to the bankrupt was given so that the bankrupt could meet its payroll; 2) the construction bills were already seven and five months overdue; 3) the note for $10,000, although due on September 15, 1961, had not been paid; 4) the bankrupt had ceased paying its rent; 5) not even a partial payment had been made on the obligations owing Appellant by the bankrupt; 6) Appellant had been informed that it would be necessary for the bankrupt to sell a capital asset in order to pay him; and 7) previous to payment Appellant had been informed by Mr. Mahl that Mahl Associates was insolvent and

that Mr. Mahl had been advised by an accountant and an attorney to file a Petition in Bankruptcy on its behalf.

In the very recent case of *I-T-E Circuit Breaker Company v. Holzman,* 354 F 2d 102, this Court stated on page 105 of the opinion,

> ". . . The test of when a creditor has such reasonable cause has often been said to be when such a state of facts is brought to the creditor's notice, respecting the affairs and pecuniary condition of the debtor, as would lead a prudent business person to the conclusion that the debtor is insolvent. (Citations omitted) A creditor may not close his eyes in order to remain ignorant of the debtor's true condition; and the creditor is chargeable with notice of all facts which a reasonably diligent inquiry would have disclosed." (Citations omitted)

The Court in *I-T-E Circuit Breaker,* supra, upheld the Trial Court's decision that a preferential transfer had been made on substantially less evidence of reasonable cause to believe than is present here. In that case the Trial Court based its finding on the facts that 1) though Appellant repeatedly requested financial statements from the bankrupt, none was ever submitted; 2) before the alleged preferential transferee knew the bankrupt was factoring its accounts; 3) the transferee knew that the bankrupt was consistently delinquent in meeting its bills from the transferee. The case at bar is substantially stronger in that the creditor had actually been informed before the transfer that the bankrupt had been advised

by an accountant and an attorney to file a Petition in Bankruptcy. This very significant fact alone sets the present case apart from any of the cases cited by Appellant in his Brief. How, on this state of this record can it be said that the District Court was clearly erroneous in finding that Appellant had "reasonable cause to believe?"

E. THE COURT DID NOT ERR IN EXCLUDING THE EVIDENCE OFFERED BY APPELLANT THROUGH MESSRS. HOLDERLY AND VEDOVIC.

Appellant now asserts that the offered testimony of Messrs. Holderly and Vedovic was offered to prove that if Appellant had made a reasonable diligent inquiry into the affairs of Mahl Associates, such inquiry would not have revealed to Appellant that Mahl Associates was insolvent. Appellee believes that this argument has no merit whatsoever and that it borders on frivolity. When the testimony of these two gentlemen was offered, Appellee objected to their testifying on the ground that the names of these proposed witnesses were not set forth on the pre-trial statement as potential witnesses (R.T. 101, 121). Appellant then claimed that the sole purpose of the offered testimony was impeachment, and under those circumstances it was not necessary to list them on the pre-trial statement (R.T. 101). It would have been improper for the Court to receive the testimony for the purposes now urged by Appellant even if such testimony were otherwise admissible or relevant.

Appellant offered to produce evidence of credit inquiries made by third parties to the Bank of California with reference to the bankrupt and the replies of the said bank. The *now* alleged purpose of this evidence was to demonstrate that if Appellant had made diligent inquiry the answer of the Bank of California might have revealed a condition other than insolvency. Aside of being opinion, conclusion and hearsay, this evidence would be irrelevant. The issue is not what Appellant might have been led to believe if he had acted diligently, *but rather whether he had reasonable cause to believe the actual proved fact of insolvency according to what he did know.* There is no evidence that Appellant made any inquiry to the Bank of California with reference to the financial condition of the bankrupt. What other creditors may have done and what information they may have garnered is wholly irrelevant to this case.

For the very same reasons, the proffered hearsay testimony of Ernest Vedovic was properly excluded. Furthermore, Appellant did not need a Dun and Bradstreet report to tell him how sound a tenant Mahl Associates was. Appellant himself as the landlord well knew that the bankrupt never paid its rent on time and that on the date of the transfer was at least a month in arrears on rent payments. Any information that Dun and Bradstreet might have had with reference to the bankrupt's rent-paying habits it must have gotten from Appellant.

III. CONCLUSION

Appellee respectfully submits that he has proved by substantial evidence all the elements of a voidable preference, and that the decision of the Court below was not clearly erroneous.

Dated, Burlingame, California,
November 17, 1966.

Respectfully submitted,
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By HENRY COHEN,
Attorneys for Appellee,
John M. England, as Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HENRY COHEN,
Attorney for Appellee,
John M. England, as Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt.